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Supreme Court, U.S.
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No. 89-____

IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

RAYMOND PROZZILLO, JESS BOROWSKI, BETTY GILL, JOHN CARSON and Marion County, West Virginia,
Petitioners,

v.

AMERICAN STATES INSURANCE COMPANY,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

JOHN C. HIGINBOTHAM
Assistant Prosecuting Attorney of Marion County
Marion County Courthouse
Fairmont, West Virginia 26554
(304) 367-5380/(304) 366-2900

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QUESTION PRESENTED

Whether a person holding funds that may belong to a taxpayer, who pays them to the Internal Revenue Service in response to a levy, should be liable for such payment to a third party that later establishes its ownership of the funds.

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RAYMOND PROZZILLO, JESS BOROWSKI, BETTY GILL, JOHN CARSON and MARION COUNTY, WEST VIRGINIA,
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v.

AMERICAN STATES INSURANCE COMPANY,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

The Petitioners respectfully pray that a writ of certiorari issue to review a judgment and opinion of the United States Court of Appeals for the Fourth Circuit entered in this proceeding on July 20, 1989

OPINIONS BELOW

The opinions of the Court of Appeals for the Fourth Circuit and of the District Court for the Northern District of West Virginia, which are not reported, appear in the Appendix at pages 1A - 3A and 4A - 12A, respectively.

JURISDICTION

The judgment of the Court of Appeals for the Fourth Circuit was entered on July 20, 1989, and this petition for certiorari was filed within ninety days of that date. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

This case involves the construction and application of sections 6321, 6322, 6331, 6332, 6343, 6532, and 7426 of the Internal Revenue Code of 1954 (26 U.S.C.). The full text of the relevant portions of such statutes are printed in Appendix C at pages 13A - 18A. Unless otherwise noted, all statutory references are to the Internal Revenue Code of 1954 (26 U.S.C.), as amended (the Code or I.R.C.)

STATEMENT

On July 1st, 1981, Arthur H. Stover, doing business as P & S Coal and Construction Company entered into a contract for $203,000.00 with the Marion County Commission to do site preparation for a City/County Complex in the City of Fairmont, Marion County, West Virginia. American States Insurance Company provided statutorily required performance and third party payment bonds. On September 21, 1981, the Internal Revenue Service made an assessment of withholding taxes against P & S for the calendar quarter ended June 30, 1981, in the approximate amount of $13,881.36.

About December 1st, 1981, P & S defaulted upon the contract and asked American States to finish the job. By letters dated December 15th, 1981, both P & S and American States notified the Marion County Commission of the default and requested retention of all contract balances and retainages, which was $60,377.00.

On July 9th, 1982, notices of levy in the amount of $17,546.36 were issued by Emerson A. McGrew, IRS Revenue Officer, and were served upon the Marion County Commission and American States Insurance Company. The notice of levy was received in Marion County on July 12th, 1982. Sometime between July 12th and July 26th, 1982, John P. Carson, Administrative Assistant to the Marion County Commission, telephoned Revenue Officer McGrew and learned that American States had requested a hold on any payments for the contract, and had denied liability on the part of American States Insurance Company for payment on the notice of levy. Thereupon by a letter dated July 26th, 1982, Mr. Carson requested a legal opinion from Marion County Prosecuting Attorney Charles E. Anderson whether the County Commission should pay the levy. By letter dated August 4th, 1982, Prosecuting Attorney Anderson informed Mr. Carson that the levy should be paid. Meanwhile, E. Joel Wesp, Counsel for American States, began negotiations with the Internal Revenue Service to obtain relief from the levy with a four page letter dated August 17th, 1982, to Revenue Officer McGrew outlining the basis for American States' contest of the levy. This letter indicated knowledge on the part of the Respondent that notices of levy had been served by the Internal Revenue Service upon one or more owners of projects on which it was the performance and payment bond surety. No copy was sent to the Marion County Commission.

On September 20, 1982, Marion County issued a check in the amount of $17,546.36 to the Internal Revenue Service in response to the levy. A Form 668-R Release of Levy dated September 24th, 1982, was sent to and received by American States on September 28th, 1982.

By letter dated October 13th, 1982, the county Commission notified American States that the Commission

was aware of certain unpaid bills for services and that these bills would be paid by the Commission unless exception was made. American States did make exception by telegram dated October 21st, 1982. By letter dated November 5th, 1982, Prosecuting Attorney Anderson further advised the County Commission to form an escrow account for the balances and retainages and to make no payment from the account without the approval of American States. The balance was paid into an escrow account. A Certificate of Completion was issued November 4, 1982. Between December 17, 1982 and November 21, 1984, a total of $26,470,20 was disbursed from the escrow account and there was no dispute regarding the payments or balances with the exception of a single $3,000.00 payment made to the County Commission for "extraordinary administrative and legal expenses incurred by the Commission" paid approximately December 20th, 1982. On February 22nd, 1983, counsel for American States appeared before the Marion County Commission regarding payments to be made to American States or other creditors and by letter dated February 25th, 1983, to Prosecuting Attorney Anderson, expressed his concern regarding the payment of the IRS notice of levy and requested a rationale therefor.

Respondent then filed this diversity action on January 30,1985, in the United States District Court for the Northern District of West Virginia to recover $35,689.66 in retainages, contract balances and third-party payments. The jurisdiction of the District Court was invoked under 28 U.S.C. § 1332 because of the diversity of citizenship, petitioners being citizens of the State of West Virginia and respondent being a citizen of the State of Indiana, and there being more than $10,000.00 in controversy. An additional basis for jurisdiction was alleged

under 28 U.S.C. § 1343, in that the respondent was bringing the action for relief under the Civil Rights Act, 42 U.S.C. § 1983. The District Court entered judgment in favor of respondent in the amount of $36,866.80, plus interest, which amount included the $17,546.86 paid to the Internal Revenue Service. The District Court found the petitioners liable for such payment on the grounds that seven months prior to the service of the notice of levy the funds in question had been assigned to the respondent and were no longer property of the taxpayer subject to seizure for his taxes. The payment was therefore held to be wrongful and the petitioners subject to liability. The Court of appeals affirmed on essentially the same grounds: that the petitioners knew of the assignment by the construction company to the respondent and had no right to treat the retained funds as property of the construction company subject to its command and to the levy of the Internal Revenue Service.

REASONS FOR GRANTING THE WRIT

1. The Decision Below Conflicts In Principle With A Decision Of This Court As To The Legal Responsibilities Of Persons Holding Funds That May Belong To A Taxpayer And Upon Whom An Internal Revenue Levy Is Served.

The Court of Appeals has decided an important question of federal law in a way that conflicts with a decision of this court and one other circuit. The question presented has great administrative importance and involves substantial amounts of revenue, for the Internal Revenue Service serves over a million levies per year. Review by this Court is therefore appropriate.

In 1985, this Court, in a case also involving the rights of nontaxpayer third parties to funds levied upon, had occasion to give support to the concept of discharge from

liability of persons honoring a levy. In *United States* v. *National Bank of Commerce*, 72 U.S. 713 (1985), the Service levied upon a joint bank account for taxes due from only one of the three codepositors. Upon refusal of the Bank to comply with the notice of levy, the Service brought an action under section 6332 for failure to honor the levy. The taxpayer codepositor, under Arkansas law, had the right to withdraw all of the funds in the account notwithstanding the fact that the other codepositors might have ownership rights in such funds. The Service contended that this right to withdraw all of the funds was a property right that was subject to levy under section 6331. The Bank contended that the Service must first demonstrate that the taxpayer was in fact the true owner of all the funds before the levy could be enforced. The Court, in holding for the Service, had occasion to review the entire statutory system of tax collection, and along with it the liability to nontaxpayers of a person honoring a levy. Specifically, the Court noted a "pay now, litigate later" policy emerging from the synthesis of these code sections. Its statements, beginning at page 728, are particularly instructive:

> In its understandable concern for Ruby's and Neva's property interests, the Court of Appeals has ignored the statutory scheme established by Congress to protect those rights. Crucially, the administrative levy, as has been noted, is only a provisional remedy. 'The final judgment in [a levy] action settles no rights in the property subject to seizure.' *United States* v. *New England Merchants National Bank*, 465 F. Supp. 83, 87 (Mass. 1979). Other claimants, if they have rights, may assert them. Congress recognized this when the Code's summary-collection procedures were enacted, S. Rep. No. 1708, 89th Cong., 2nd Sess. 29 (1966), U.S. Code Cong. & Admin. News 1966, p. 3722, and when it provided in § 7426, of the

> Code, 26 U.S.C. § 7426, that one claiming an interest in property seized for another's taxes may bring civil action against the United States to have the property or the proceeds of its sale returned. Congress also has provided, by § 6343(b), an effective and inexpensive administrative remedy for the return of the property. See Treas. Reg. § 301.6343-1(b)(2), 26 CFR § 301.6343-1(b)(2) (1984).
>
> Congress thus balanced the interest of the Government in the speedy collection of taxes against the interests of any claimants to the property, and reconciled those interests by permitting the IRS to levy on the assets at once, leaving ownership disputes to be resolved in a post-seizure administrative or judicial proceeding. See, *United Sand & Gravel Contractors, Inc.* v. *United States*, 624 F.2d 733, 739 (CA5 1980); *Valley Finance, Inc.* v. *United States*, 203 U.S.App.D.C. 128, 136-137, 629 F.2d 162, 170-171 (1980), cert. denied, 451 U.S. 1018, 101 S. Ct. 3007, 69 L.Ed.2d 389 (1981). Its decision that certain property rights must yield provisionally to governmental need should not have been disregarded by the Court of Appeals. *Nor would the bank be exposed to double liability were it to honor the IRS levy. The Code provides administrative and judicial remedies for codepositors against the Government, and any attempt to secure payment in this situation from the bank itself would be contrary to the federal enforcement scheme.* (Footnotes omitted) (Emphasis added)

The Court is apparently indicating that the administrative and judicial remedies provided to third parties for protection of their rights in a wrongful levy situation eliminate the need for a remedy against the person honoring the levy. Such a rule would encourage rapid collection of taxes and yet not deprive third parties of adequate relief on the securing of their property.

Lower courts, both state and federal, have consistently held stakeholders not liable to nontaxpayer third parties

claiming ownership of funds the stakeholders had previously paid to the Service pursuant to a levy.

In *Determan* v. *Jenkins*, 111 F. Supp. 604 (N.D. Ga. 1953), a sheriff took possession of an amount of currency found in the wreckage of an airplane and later surrendered it to the Service pursuant to a notice of levy. In a suit against the sheriff by a nontaxpayer third party claiming ownership of the funds, the court declined to find liability. In that case, as in the instant one, the plaintiff argued that the property was not subject to levy because it belonged to the plaintiff and not to the taxpayer. This argument was rejected because it would have required the party upon whom levy was made to ascertian the true title to the money before delivering it to the Service. The court thus lifted the risk of that decision from the innocent stakeholder and in so doing gave support to the policy of speedy collection of the revenue. The rule of this case was next acknowledged in *Fine Fashions, Inc.* v. *Moe*, 172 F. Supp. 547 (S.D. N.Y. 1959), although the issue of the stakeholder's liability to a third party was not before the court.

Fourteen years after *Determan*, in *Bolling* v. *Samples*, 159 S.E.2d 727 (Ct. App. Ga. 1967), the Georgia Court of Appeals also adopted the rule that a person making payment pursuant to a levy was discharged from liability to a third party. There, the taxpayer had, prior to the date of the levy, assigned the debt to the person who brought the action against the party levied upon.

The next case to deal with liability to a third party was *DiEdwardo* v. *First National Bank of Bath*, 442 F. Supp. 499 (E.D. Pa. 1977). There the Service levied upon bank deposits carried in the names of the plaintiffs for taxes of another person. The Service contended later that the

plaintiffs were merely nominees of the taxpayer and that the taxpayer was the true owner of the funds. The Bank paid the money over notwithstanding the fact that there had not been any legal determination that the funds belonged to the taxpayer. In finding the Bank not liable, the court acknowledged the long standing rule that payment pursuant to a notice of levy is a complete defense to any action by a taxpayer, citing *United States* v. *Eiland*, 223 F.2d 118 (4th Cir. 1955), and extended such protection to suits by third parties. The court also noted that the plaintiffs had the right to directly sue the United States under section 7426 wherein all questions could be resolved.

Although different rationales were used in *Determan* and *DiEdwardo*, these cases show that where the issue of liability has been raised, federal courts have exonerated the person honoring the levy.

Finally, the Sixth Circuit, in *United Pacific Insurance Company* v. *Laurel County*, 805 F.2d 628 (6th Cir. 1986), *cert. denied*, ___ U.S. ___, 108 S. Ct. 72 (1987), a case very similar to the instant one, held that honoring a notice of levy was a complete defense to a suit by a third party claiming ownership of the fund.

In the present case the focus should be from the viewpoint of the stakeholder, Marion County, at the time the notice of levy was served on July 9, 1982. According to the notice of levy the tax was assessed on September 21, 1981, at which time a federal tax lien arose. Sections 6321 and 6322. This lien attached to all property and rights to property of the taxpayer, including after-acquired property. *Glass City Bank* v. *United States*, 326 U.S. 265 (1945). The tax lien arose *prior* to the default of P & S and thus encumbered its rights under the construction con-

tract before they were assigned to the respondent. Other uncertainties at the time of the notice of levy also clouded the effectiveness of the assignment and the extent of the taxpayer's interest in the contract proceeds.

The contract was being funded by the United States acting through the Farmers Home Administration. The assignment may have been invalid by reason of the Anti-Assignment of Claims Statute, 31 U.S.C. § 3727.

Section 23.1 of the Site Development Contract provided that neither the contractor (taxpayer) nor the owner (Marion County) shall sell, transfer, assign, or otherwise dispose of the contract or any portion thereof, or any right, title or interest therein, or any obligations thereunder, without written consent of the other party. Marion County had not given written consent to the taxpayer's assignment to American States. Consequently, doubt was cast upon the validity of the assignment by the contract itself.

Section 18.2 of the contract provides that in the event the contractor violates any provisions of the contract (such as failure to pay suppliers, or failure of performance) the owner may terminate the contract. The contractor's right to payment is not totally cut off at that time, however. At the completion of the contract, if the unpaid balance of the contract price exceeds the direct and indirect costs of completing the contract, including compensation for additional professional services, such excess shall be paid to the contractor. The Certificate of Substantial Completion establishes that the contract was not completed until November 8, 1982, almost four months after the notice of levy was served. Consequently, the taxpayer's entitlement to some portion of the contract proceeds could not have been determined with absolute certainty until that later date.

Whether and to what extent these uncertainties may have given the Internal Revenue Service an interest in the funds being held by Marion County could very well have become the subject of protracted litigation if it had not promptly honored the notice of levy. If such litigation ultimately had been resolved in favor of the Internal Revenue Service, Marion County could have been subject to substantial penalties. See section 6332. The rationale of the *Determan* case is that an innocent stakeholder should not be exposed to the risk of having to determine ownership of the funds.

Admittedly, Marion County, and other similarly situated stakeholders could file an interpleader suit and let a court determine ownership. Such course of action, however forces the stakeholder through no fault of its own to incur costs and attorney's fees. In a case such as the instant one, where the tax liability exceeds the interpleaded fund, the stakeholder cannot recover its legal expenses from the fund if the Service prevails. *United States* v. *Liverpool & London & Globe Insurance Co.*, 348 U.S. 215 (1955). In any event, it is more the obligation of the person claiming ownership of the property to take the initiative rather than the stakeholder, and either to file a claim with the Internal Revenue Service under section 6343, or to bring an action under section 7426. The law has always imposed a duty on the owners of property to exercise some reasonable effort to care for it. *Dieckmann* v. *United States*, 550 F.2d 622, 624 (10th Cir. 1977).

In the instant case, American States was aware as early as its letter of August 17, 1982, that notices of levy had been served upon one or more owners of projects on which it was performance and payment bond surety, including Marion County. American States also received a Form 668-R, Release of Levy, on September 28, 1987, indicat-

ing that, in some manner, the notice of levy had been satisfied. By a letter dated February 25, 1983, counsel for American States indicated its awareness, at some time prior thereto, of the payment by Marion County of the Internal Revenue Service notice of levy.

Under section 6532(c)(1), a suit under section 7426 for wrongful levy must be begun no later than nine months from the date of the levy. In the instant case, this would have been April 9, 1983. Section 6532(c)(2) provides further that if a request is made for the return of property under section 6343(b), the aforementioned nine-month period shall be extended for a period of twelve months from the date of such request or for a period of six months from the date of disallowance of the request by the Internal Revenue Service, whichever is shorter.

As of February 25, 1983, the date of its counsel's letter, American States still had forty-three days in which to file with the Internal Revenue Service a simple request for return of the payment made by Marion County or to file suit under section 7426. This request would have extended the period for American States to file an action under section 7426 for a minimum of six months. During such period it could have entered into negotiations with the Internal Revenue Service for return of the money and perhaps resolved the matter short of litigation. As indicated in *National Bank of Commerce* this is precisely what is envisioned by the statutory processes provided under sections 6343 and 7426.

American States probably was aware of the payment to the Internal Revenue Service long before February 25, 1983. It was certainly aware of the notice of levy served upon Marion County soon after July 9, 1982. Notwithstanding this knowledge, it sat on its rights, and whether

because of indifference, negligence, or other unknown reasons, failed to avail itself of these remedies which have been provided by Congress since 1966. The legal system should not visit the failure of American States to avail itself of these remedies upon the innocent stakeholder paying under the levy.

2. The Decision Below Conflicts With The Decision Of Another Court Of Appeal As To The Liability Of A Stakeholder To A Nontaxpayer Third Party Who Claims Ownership Of Funds Paid By The Stakeholder To The Internal Revenue Service Pursuant To A Notice Of Levy.

In *United Pacific Insurance Company* v. *Laurel County*, 805 F.2d 628 (6th Cir. 1986), *cert. denied*, ___ U.S. ___, 108 S. Ct. 72 (1987), Laurel County, Kentucky, had contracted with Y & S Construction Company to construct a high school in London, Kentucky. For the period July through December 1969, Y & S had failed to remit withholding taxes for its employees in the approximate amount of $185,000.00. On February 4, 1970, the Internal Revenue Service filed a notice of tax lien against Y & S for this amount. On or before March 4, 1970, Y & S defaulted in the performance of the construction contract when it was about seventy-five percent completed. On March 15, 1970 Y & S sent a notice to Laurel County that all funds due or about to be due on the contract be paid to its surety, United Pacific Insurance Company. On or about April 17, 1970, the project architect certified that $116,000.00 was due and payable to Y & S. On May 15, 1970, United Pacific made demand on Laurel County for all sums coming due under the contract. Three days later a notice of levy was served on Laurel County by the Internal Revenue Service in the approximate amount of $100,000.00 for taxes due and owning by Y & S. On May 18, 1970, after consulting with two county attorneys,

Laurel County paid the amount of the levy to the Internal Revenue Service. On that same day it also advised United Pacific of the payment. In 1974, more than nine months after the notice of levy, United Pacific brought an action against Laurel County for damages in the amount paid by it pursuant to the notice of levy. Laurel County filed a third party complaint against the United States which was later dismissed because it had not been brought within the nine-month period specified in section 6532(c)(1).

The district court found for United Pacific on the ground that under Kentucky law the funds were held in trust for the unpaid materialmen and had never become property of the taxpayer. In so ruling, the court noted that section 6332(d) does not relieve a person mistakenly or erroneously making payment to the Internal Revenue Service pursuant to a notice of levy from liability to the true owner of the funds.

The Sixth Circuit first rejected the lower court's holding that the property was held in trust for the benefit of materialmen and concluded that the taxpayer at the time of levy did have an interest in the fund subject to levy. United Pacific failed to argue in the alternative that the taxpayer would still not have had an interest in the contract proceeds based upon its default and failure to pay its materialmen, although the record before the court clearly supported such a position. The court then held that where a custodian of a taxpayer's property or rights to property has, *at the time of levy,* no defense for failure to comply with the levy (i.e., the custodian cannot claim that it is neither "in possession of" nor "obligated with respect to" property of the taxpayer or that the taxpayer's property is subject to a prior judicial attachment or execution) and thus honors a lawful Internal Revenue Service levy, the

custodian has a valid and complete defense under federal law to claims of third parties with interests in the property surrendered.

In the instant case, at the time the levy was made, the proceeds of the construction contract were not under attachment or execution. Moreover, substantial uncertainty existed as of July 9, 1982, as to what portion of the contract proceeds may have constituted property of the taxpayer. The taxpayer's purported assignment of its interest thereunder was subject to a prior, existing federal tax lien, the assignment may have been invalid because Marion County had not consented to it in writing, and under the contract, the taxpayer may have been entitled to excess proceeds, a fact not determinable until the later completion of the project.

It is clear the Sixth Circuit implicitly recognized that in any levy situation subsequent litigation may determine the taxpayer had no rights in the property. Nevertheless, it focused upon the situation as it existed *at the time of levy,* prior to a judicial resolution of the respective interests in the subject property. Its decision, therefore, is in direct conflict with that of the court below.

3. The Decision Below Raises Significant and Recurring Problems Concerning Application of the Federal Tax Lien Act.

In its Petition for Writ of Certiorari filed with respect to *United States* v.*National Bank of Commerce,* 472 U.S. 713 (1985), the United States, at page 19, footnote 13, thereof set forth statistics obtained from the Internal Revenue Service concerning the number of levies served during the fiscal years 1981, 1982, 1983, and the first half of 1984. The numbers served were, respectively, 740,103; 1,058,452; 1,390,900; and, 741,900. Presumably, the

number of levies being served currently per fiscal year is equal to or more than those set forth above. In any event, the amount is substantial.

It is important to note that the statutory scheme regarding levies and remedies for third party claimants indicates Congressional intent to effect a speedy collection of the revenue. Section 6332 provides for substantial penalties for refusal to pay which has been characterized as a coercive purpose "which seeks to foster swift tender of property which has been levied upon." See *Flores* v. *United States*, 551 F.2d 1169, 1174 (9th Cir. 1977). Section 6532(c) further provides that actions under section 7426 for wrongful levy must be commenced within nine months from the date of the levy. "Congress was clearly concerned that the levy contests more than nine months after the levy would prevent ultimate collection of the tax, thereby endangering the federal treasury. The problems of administration become inordinately complex after a levy is set aside for the Government must begin anew to collect the delinquent tax. Physical collection becomes far less likely, as taxpayers may have disappeared or disposed of their assets in the intervening period." *Gordon* v. *United States*, 649 F.2d 837, 843 (Ct. Cl. 1981). Thus, federal decisional law should support this clear statutory intent by encouraging prompt payment of monies levied upon through the elimination of liability for such payment.

In the absence of a rule providing for discharge of liability upon payment, the person levied upon has no certain or reasonable alternatives.

As pointed out previously, the filing of an interpleader action by the possessor of the funds is likewise not a certain or reasonable solution. It is only certain if the

stakeholder is aware of all potential claimants to the fund and names them parties to the interpleader. Secondly, it is not reasonable to require the innocent possessor to incur substantial legal expenses in the filing of an interpleader action when such expenses may not be recoverable from the fund. In cases where it is ultimately determined that the federal tax lien has priority and is equal to or exceeds the fund, the interpleading stakeholder is not permitted to recover its legal expenses therefrom. *United States* v. *Liverpool & London & Globe Ins. Co.*, 348 U.S. 215 (1955).

The other alternative available to the person levied upon is to refuse to honor the levy. Under section 6332(c), however, the person could be subject to penalties equal to the amount not paid (not to exceed the taxes to be collected by the levy) and an additional fifty percent thereof if the refusal to pay was unreasonable. Thus, if this course of action is followed, the person is exposed to the risk that it will later be determined that the taxpayer was the true owner of the funds and the levy was valid, with the resultant imposition of the penalties. For a thorough discussion of the dilemmas confronting persons upon whom a levy is made the Court's attention is invited to Plumb, *Federal Liens and Priorities—Agenda for the Next Decade* (pt. III), 77 Yale L.J. 1104, 1155 (1968).

As indicated above, neither of these alternatives are certain or reasonable, and would serve only to impede the swift collection of the revenue. It is apparent, therefore, that there exists substantial policy reasons for a general discharge from liability to third parties upon payment pursuant to a levy.

The Internal Revenue Code provides some relief to stakeholders paying pursuant to a levy, but fails to

address situations where it is ultimately determined the taxpayer had no property interest in the subject funds. In 1966, when the Federal Tax Lien Act was passed, section 6332(d) provided for the first time that any person in possession (or obligated with respect to) property subject to levy upon which levy has been made, who surrenders that property to the Internal Revenue Service will be discharged from liability to the taxpayers.

In 1988, under Pub. L. 100-647 (TAMRA), the foregoing section was redesignated as section 6332(e), effective for levies issued on or after July 1, 1989, and provides as follows:

> (e) EFFECT OF HONORING LEVY.—Any person in possession of (or obligated with respect to) *property or rights to property subject to levy* upon which a levy has been made who, upon demand by the Secretary, surrenders such property or rights to property (or discharges such obligation) to the Secretary (or who pays a liability under subsection (d)(1) shall be discharged from any obligation or liability to the delinquent taxpayer and any other person with respect to such property or rights to property arising from such surrender or payment. (Emphasis added)

"Property or rights to property subject to levy" is limited by section 6331(a) to property and rights to property belonging to the taxpayer or upon which there is a tax lien. In any case where subsequent litigation determines (1) that the taxpayer never had any rights in the property levied upon, or (2) that the property was transferred from the taxpayer before the tax lien came into existence, section 6332(e) would offer no relief to the stakeholder who mistakenly, although in good faith, honors the levy. This section would only give relief where it is later determined that the claim of a third party had priority over the

federal tax lien with respect to property that did, in fact, belong to the taxpayer.

In the construction contract area alone there are numerous situations where, because of the taxpayer's default in performance or failure to pay suppliers, he will have no property interest in the proceeds of the contract. In other areas such as bank deposits with nontaxpayer co-depositors as in the *National Bank of Commerce* case, the same problem will arise to confront the thousands of banks that are served with notices of levy on a daily basis. See page 19, footnote 13, in the Petition for Writ of Certiorari in *National Bank of Commerce*.

In *Bull* v. *United States*, 295 U.S. 247, 259 (1935), this Court declared that "taxes are the life-blood of government, and their prompt and certain availability an imperious need." The administrative levy system is a time-honored, congressionally-authorized collection technique designed to ensure that this need is promptly and equitably met. The decision below poses a serious threat to the efficacy of that system.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

JOHN C. HIGINBOTHAM
Assistant Prosecuting Attorney of Marion County
Marion County Courthouse
Fairmont, West Virginia 26554
(304) 367-5380/(304) 366-2900

October 1989

CERTIFICATE OF SERVICE

I hereby certify that on October 18, 1989, three copies of the Petition for Writ of Certiorari were mailed postage prepaid, to E. Joel Wesp, Esq., Wesp & Osterkamp, LeVeque Tower, the Thirty-Third Floor, 50 West Broad Street, Columbus, Ohio 43215, Counsel for Respondent.

I further certify that all parties required to be served have been served.

JOHN C. HIGINBOTHAM
Assistant Prosecuting Attorney of Marion County
Marion County Courthouse
Fairmont, West Virginia 26554
(304) 367-5380/(304) 366-2900

APPENDIX

APPENDIX

APPENDIX A

Nos. 88-1107/1114

United States Court Of Appeals

FOR THE
FOURTH CIRCUIT

AMERICAN STATES INSURANCE COMPANY
Plaintiff-Appellee,

v.

RAYMOND PROZZILLO; JESS BOROWSKI; BETTY GILL; JOHN CARSON; MARION COUNTY, WEST VIRGINIA,
Defendants-Appellants

v.

INTERNAL REVENUE SERVICE
Third Party Defendant

v.

AMERICAN STATES INSURANCE COMPANY,
Plaintiff-Appellant,

v.

RAYMOND PROZZILLO; JESS BOROWSKI; BETTY GILL; JOHN CARSON; MARION COUNTY, WEST VIRGINIA,
Defendants-Appellees

v.

INTERNAL REVENUE SERVICE
Third-Party Defendant

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF WEST VIRGINIA, AT CLARKSBURG.
William M. Kidd, United States District Judge.
CA-85-11-C-K.

ARGUED: February 9, 1989

DECIDED: July 20, 1989

Before HALL and PHILLIPS, Cicuit Judges; and HAYNSWORTH, Senior Circuit Judge.

Before: HALL and PHILLIPS, Circuit Judges; and HAYNSWORTH, Senior Circuit Judge.

John Carder Higinbotham, Assistant Prosecuting Attorney (J. Montgomery Brown, Prosecuting Attorney on brief) for Appellants. E. Joel Wesp (Wesp, Osterkamp & Stratton on brief for Appellee).

PER CURIAM:

American States Insurance Company was the surety on construction bonds filed on behalf of Arthur H. Stover doing business as P & S Coal Construction Company. The construction company had agreed to do site work on a county construction project in Marion County, West Virginia. The bonds secured the construction company's performance and payment.

The construction company defaulted in its performance, and the appropriate officials of Marion County were informed that American States had received an assignment by the construction company of all balances and retainages by county officials for the account of the construction company.

Thereafter, the Internal Revenue Service purported to levy upon those funds as the property of the construction company for some $17,000 in taxes due by the construction company. The county paid over the funds to the Internal Revenue Service. In addition, it paid to itself $3,000 to reimburse itself for claimed extra expense to which it had been put.

The insurance company brought this action to recover the full amount of the retained funds that became due upon completion of the contract.

Marion County admitted the facts. It made no claim that it was entitled to pay itself the $3,000, but it did insist that it was entitled to deduct the amount it had paid to the Internal Revenue Service. It treated the claim of the insurance company as no more than a competing claim upon the fund. It took the position that it had no defense to the claim of the United States. In doing so it completely ignored the assignment of the construction company to the insurance company of all the construction company's interest in the funds withheld by Marion County.

There is no merit in the county's appeal. Summary judgment for the plaintiff was properly entered. The county knew of the assignment by the construction company to the insurance company and had no right to treat the retained funds as property of the construction company subject to its command and to the levy of the United States.

In addition to its contract claims, the insurance company alleged a violation of section 1983. It claimed a deprivation of its property without due process of law and done under the color of state law. It alleged the section 1983 claim in an attempt to obtain an award of attorney's fees under 42 U.S.C. section 1988.

The district judge denied the section 1983 claim upon the ground that the county's diversion of funds did not amount to a constitutional tort. Whether or not the district court was right on that score, an award of attorney's fees under section 1988 is clearly discretionary. Whether or not the district court had the power to award such fees, it clearly had the discretionary right to decline to award them. We therefore find no merit in the plaintiff's cross appeal dealing with the section 1983 claim.

AFFIRMED.

APPENDIX B

(Filed April 20, 1988)

NO. 85-0011-C(K)

United States District Court

NORTHERN DISTRICT OF WEST VIRGINIA AT CLARKSBUG

AMERICAN STATES INSURANCE COMPANY
Plaintiff.

v.

RAYMOND PROZZILLO; *et al.*
Defendants and Third-Party Plaintiffs

v.

INTERNAL REVENUE SERVICE OF THE UNITED STATES GOVERNMENT
Third-Party Defendant

MEMORANDUM OPINION

This matter is pending before the Court on plaintiff, American States Insurance Company's ("American States"), motion for summary judgment filed on November 19, 1987. The defendants have not filed a response or otherwise opposed American States' motion.

Following is the statement of undisputed material facts:

STATEMENT OF FACTS

On or about August 22, 1980, American States entered into an "Agreement of Indemnity" with Arthur S. Stove d/b/a P & S

Coal Construction Company ("P & S") which provided, *inter alia*, that, effective upon breach of any contract referred to in any surety bond issued by American States pursuant to the agreement, that P & S assign, transfer and set over to American States all of the rights of P & S in, and growing in any manner out of, and contracts referred to in the bond. Such assignment included any and all percentages retained and any and all sums that may be due or later become due on account of any and all contracts referred to in the bond.

Thereafter, on or about July 1, 1981, P & S entered into a contract with defendant Marion County and the Marion County Commission for development of a city-county complex to be located in Fairmont, West Virginia. At all times during the contract between P & S and defendant Marion County, American States provided payment and performance surety bonds on behalf of P & S for the performance of work and material under terms of the agreement.

On December 1, 1981, P & S Coal Construction Company defaulted on its obligations under its contract with defendant Marion County and requested that American States meet its bonded obligations as surety, which obligations were subsequently met by it. American States became subrogated to the rights and obligations of P & S under the Marion County contract on December 1, 1981, and it took immediate assignment from P & S of all contract balances, retainages and payments in progress.

P & S notified defendant Marion County in writing on December 15, 1981, of its default under the Marion County contract and the assignment of such contract balances and retainages to American States. P & S further requested Marion County to honor American States' requests for such contract balances and retainages as such amounts became due under the contract.

American States also notified defendant on December 15, 1981, that all contract balances, retainages and payments in progress were to be withheld until American States' surety had

fulfilled its obligations under the bond and made claims for such balances. At the time they received notice of American States' interest in the contract balance and retainages, defendants were holding approximately $60,000 under the Marion County contact which had been assigned by P & S to American States.

As early as December 30, 1981, American States began making disbursements under its bond for the benefit of unpaid subcontractors and materialmen and for the completion of the Marion County project. Prior to any disbursements from the contract balance and retainage fund by Marion County, American States had paid under its bond in excess of $140,000.

On or about July 9, 1982, the Internal Revenue Service ("IRS") issued a Notice of Levy on Wages, Salary, and other income "belonging to this taxpayer (Arthur H. Stover dba P & S Coal Co.) that you now possess or for which you become obligated." The notice of levy was received by Marion County on July 12, 1982. American States itself received a notice of levy. Ten months prior to the date on which Marion County received notice of levy, American States had succeeded to all rights in the contract balances and retainages being held by Marion County. American States notified the IRS of that fact and disputed the IRS levy.

A county administrator telephoned the IRS upon receipt of the levy and learned from an IRS agent that American States had requested a hold on any payment from the Marion County contract and denied any liability on the part of the bonding company of this Notice of Levy. The county administrator was also aware from the earlier notice from American States that it then had an interest in the funds being retained by Marion County on the contract.

On July 26, 1982, the prosecuting attorney was asked to render an opinion as to whether the County should pay the IRS levy. In a letter dated August 4, 1982, the prosecuting attorney opined that Marion County should pay the levy and deduct this from the amount "owing to P & S Coal" for their contract period. The prosecuting attorney know of American States'

position about payment of the levy out of the contract balances; but he did not make any effort to contact American States to advise it of his opinion, nor to learn anything more about American States' position. He was unaware of the prior assignment of contract balances and retainages by Art Stover and P & S to American States; and he did not consider the impact of the assignment of the contract balances in rendering his opinion.

On or about September 17, 1982, Marion County issued its check for $17,546.36 to the IRS in response to the IRS levy.

American States was never given any advance notice of Marion County's intent to pay the IRS levy and deduct the amount of the payment from the contract balances and retainages.

On September 8, 1982, American States was notified about the termination of contract and the disposition of the contract balances. This notice clearly indicated that the contract balances and retainages were being held pending completion of the project. Nothing was said about the impending payment of funds out of the contract balances to IRS.

On October 13, 1982, American States was first notified of Marion County's intent to make disbursement from the contract balances. In this letter, Marion County gave American States ten days to contest any of the proposed payments. This letter said nothing about any prior disbursement of funds to the IRS out of the contract balance account of American States.

On October 21, 1982, American States sent a telegram to Marion County noting American States' exception to any and all proposed payments being made out of the contract balances.

On November 4, 1982, the prosecuting attorney issued another opinion letter in which he changed his opinion as to American States' rights to the contract balances and retainages. He expressly advised the County that, in establishing the escrow account for the balance of the contract proceeds,

"*no payment can be made from this account without the approval of American States Insurance company.*"[1] The prosecuting attorney came to the conclusion that no payment should be from the account without the approval of American States because he knew American States was then subrogated to the rights of P & S Coal. In that regard he stated that:

> Based on the information that I had at that time, I felt that American States was subrogated to the rights of P & S Coal, as far as the monies were concerned, and that you could not make those payments without American States Insurance Company's permission.[2]

Despite the express advice, the County persisted in its failure to credit the contract balance account with the amount paid over to the IRS. In addition, the County made another disbursement of $3,000 from the contract balances for "extraordinary administrative and legal expenses incurred by the Commission."

Thereafter, on April 18, 1983, American States demanded from defendants payment of contract balances and retainages (then believed to be in the amount of $35,689.66) plus interest. However, between the notice of assignment sent to defendants on December 15, 1981, and the formal demand for the contract balance on April 18, 1983, defendant had paid the sum of $17,546.86 to the IRS in response to an IRS levy and deducted $3,000 from the balance of the contract for additional "administrative and legal costs" contrary to contract provisions.

Defendants continue to hold the sum of $16,320.44 and have refused to release even that sum to American since completion of the contract, notwithstanding the defendant's admission that, according to their view, American States became entitled to the contract balance on December 21, 1984.[3]

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[1] (C. Anderson Deposition Exhibit D-12.)

[2] (C. Anderson Deposition, Pg. 21, 11. 14-18.)

[3] Memorandum Appendix S, Defendant's Answer to Plaintiff's Interrogatory No. 27.

Discussion

In its complaint American States seeks recovery of $35,689.66 in retainages, contract balances and payment held and made by the defendants. It is undisputed that American States acted as surety on this construction project. American States issued the payment and performance bonds for the construction contract between P & S and Marion County Commission. Upon P & S's default on the contract, American States stepped in and completed the project. The numerous relevant contract documents are a part of the record herein.

The Agreement of Indemnity entered into between American States and P & S reads, in pertinent part:

Assignment

> (THIRD) The contractor, [P & S] the Indemnitors hereby consenting, will assign, transfer and set over, and does hereby assign, transfer and set over to the Surety, [American States] as collateral to secure the obligations in any and all of the paragraphs of this Agreement and any other indebtedness and liabilities of the Contractor to the Surety, whether heretofore or hereafter incurred, the assignment in the case of each contract to become effective as of the date of the bond[s] [payment and performance bonds] covering such contract, but only in the event of (1) any abandonment, forfeiture or breach of any contracts referred to in the Bonds or of any breach of any said Bonds: . . . (e) Any and all percentages retained and any and all sums that may be due or hereafter become due on account of any and all contracts referred to in the Bonds and all other contracts whether bonded or not in which the contractor has an interest.

American States indicates that it is entitled to the contract proceeds and retainages as a result of its subrogation rights arising from its fulfilling all responsibilities under the bonds. The Court agrees with this contention. It is undisputed American States, as surety, completed the project.[4]

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[4] The defendants admitted that a certificate of substantial completion was issued by the project architect on or about November 4, 1982.

The United States Supreme Court has stated that a "[s]urety, which paid labor and material bills incurred by a governmental contractor, had ownership of an equitable lien in, or a prior right to retained percentages from the date of execution of the bond and contract on the theory of subrogation alone." *Logan Planning Mill Co.* v. *Fidelity and Casualty of N.Y.*, 212 F. Supp. 906, 916 (S.D. W. Va. 1962) (citing, *Pearlman* v. *Reliance Insurance Company*, 371 U.S. 132, 83 S.Ct. 232 (1962)).

The equitable lien created by American States' performance as surety under the bonds is bolstered by the legal rights stemming from the express contractual assignment provision quoted above.

Under West Virginia law "[s]ubrogation, being a creation of equity, will not be allowed except where the subrogee [American States] has a clear case of right and no injustice will be done to another." *Ray* v. *Donohew*, 352 S.E.2d 729 (W. Va. 1986) (citations omitted). Here, American States has a clear right to the contract proceeds in question. The Court sees no injustice being done by invoking subrogation in this case.

Moreover, the equitable rights of American States relates back in time to the execution of the specific bonds. *Western Casualty and Surety Company* v. *Brooks*, 362 F.2d 486, 490 (4th Cir. 1966). The two bonds were issued by American States on July 1, 1981. Thus, the subrogation rights acquired by American States related back and attached as of July 1, 1981.[5] Given that American States had acquired subrogation rights upon completion of the Marion County project and the defendants fully recognizing that certain contract proceeds had been retained which arguably inured to the benefit of American States, the defendant Marion County Commission, in paying a portion of the retained proceeds to the IRS under the Notice of

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[5] The Court notes that the IRS Notice of Levy was dated July 9, 1982, one year after the issuance of the payment and performance bonds by American States.

Levy for P & S did so at its own risk. It remains undisputed that the IRS levy was received by Marion County on July 12, 1982, some seven months following P & S's default and after it received notice of the assignment to American States.

The Court is of the opinion that although there were mechanisms available to protect the defendants from improper disbursement of the retained proceeds, none were utilized. The amount disbursed to the IRS under the P & S levy was $17,546.86. However, the Court primarily is concerned with deciding whether American States is entitled to judgment as a matter of law in the amount sought. In addition, defendants disbursed another $3,000 from the contract balances earmarked as legal and administrative expenses. This disbursement was apparently made without either the knowledge or consent of American States and against the advice of defendants' counsel. It remains undisputed that there was no contractual provision authorizing the $3,000 disbursement. Defendants' lack of opposition to this motion is deemed to have been an admission of the material facts stated by American States in its memorandum. *Local Court Rule* 2.07 (N.D. W. Va.).

Upon the undisputed material facts, the Court concludes, in accordance with the mandates of *Celotex Corp.* v. *Catrett*, 106 S.Ct. 2548 (1986) and Rule 56, Federal Rules of Civil Procedure that: (1) there are no genuine issues as to any material fact and American States is entitled to judgment as a matter of law; (2) American States is entitled to the retained contract proceeds in the amount of $36,866.80 for the reasons set forth herein; (3) American States is entitled to prejudgment interest on the amount of $36,866.80 from November 4, 1982, at the rate of 10% pursuant to West Virginia Code § 56-6-31; (4) American States shall be entitled to post-judgment interest pursuant to West Virginia Code § 56-6-31; and (5) Marion County Commission's actions complained of herein, do not rise to the level of a constitutional violation; therefore, under the circumstances presented, American States shall not be entitled to an award of attorney fees.

It is therefore ORDERED that American States' motion for summary judgment is hereby granted.

Judgment shall be entered in accordance with the provisions of this Opinion.

The Clerk is directed to transmit certified copies of this Order to counsel of record herein

ENTER:

WILLIAM M. KIDD
UNITED STATES DISTRICT JUDGE

APPENDIX C

Internal Revenue Code of 1954 (26 U.S.C.), as amended and as in effect for the years at issue, unless specifically noted otherwise:

SEC. 6321. LIEN FOR TAXES.

If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.

SEC 6322. PERIOD OF LIEN.

Unless another date is specifically fixed by law, the lien imposed by section 6321 shall arise at the time the assessment is made and shall continue until the liability for the amount so assessed (or a judgment against the taxpayer arising out of such liability) is satisfied or becomes unenforceable by reason of lapse of time.

SEC. 6331. LEVY AND DISTRAINT.

(a) *Authority of Secretary.*—If any person liable to pay any tax neglects or refuses to pay the same within 10 days after notice and demand, it shall be lawful for the Secretary to collect such tax (and such further sum as shall be sufficient to cover the expenses of the levy) by levy upon all property and rights to property (except such property as is exempt under section 6334) belonging to such person or on which there is a lien provided in this chapter for the payment of such tax. Levy may be made upon the accrued salary or wages of any officer, employee, or elected official, of the United States, the District of Columbia, or any agency or instrumentality of the United States or the District of Columbia, by serving a notice of levy on the employer (as defined in section 3401(d)) of such officer, employee, or elected official. If the Secretary makes a finding that the collection of such tax is in jeopardy, notice and demand for immediate payment of such tax may be made by the Secretary and, upon failure or refusal to pay such tax, collection thereof by levy shall be lawful without regard to the 10-day period provided in this section.

*****

SEC. 6332. SURRENDER OF PROPERTY SUBJECT TO LEVY.

(a) *Requirement.*—Except as otherwise provided in subsection (b), any person in possession of (or obligated with respect to) property or rights to property subject to levy upon which a levy has been made shall, upon demand of the Secretary, surrender such property or rights (or discharge such obligation) to the Secretary, except such part of the property or rights as is, at the time of such demand, subject to an attachment or execution under any judicial process.

*****

(c) *Enforcement of Levy.*—

(1) *Extent of personal liability.*—Any person who fails or refuses to surrender any property or rights to property, subject to levy, upon demand by the Secretary, shall be liable in his own person and estate to the United States in a sum equal to the value of the property or rights not so surrendered, but not exceeding the amount of taxes for the collection of which such levy has been made, together with the costs and interest on such sum at an annual rate established under section 6621 from the date of such levy (or, in the case of a levy described in section 6331(d)(3), from the date such person would otherwise have been obligated to pay over such amounts to the taxpayer). Any amount (other than costs) recovered under this paragraph shall be credited against the tax liability for the collection of which such levy was made.

(2) *Penalty for violation.*—In addition to the personal liability imposed by paragraph (1), if any person required to surrender property or rights to property fails or refuses to surrender such property or rights to property without reasonable cause, such person shall be liable for a penalty equal to 50 percent of the amount recoverable under paragraph (1). No part of such penalty shall be credited against the tax liability for the collection of which such levy was made.

(d)—*Effect of Honoring Levy.*—Any person in possession of (or obligated with respect to) property or rights to

property subject to levy upon which a levy has been made who, upon demand by the Secretary, surrenders such property or rights to property (or discharges such obligation) to the Secretary (or who pays a liability under subsection (c)(1) shall be discharged from any obligation or liability to the delinquent taxpayer with respect to such property or rights to property arising from such surrender or payment. In the case of a levy which is satisfied pursuant to subsection (b), such organization shall also be discharged from any obligation or liability to any beneficiary arising from such surrender or payment.

* * * * *

Under Pub. L. 100-647 (TAMRA), former section 6332(d) was replaced, as of July 1, 1989, by section 6332(e) which provides as follows:

(e) *Effect of Honoring Levy.*—Any person in possession of (or obligated with respect to) property or rights to property subject to levy upon which a levy has been made who, upon demand by the Secretary, surrenders such property or rights to property (or discharges such obligation) to the Secretary (or who pays a liability under subsection (d)(1) shall be discharged from any obligation or liability to the delinquent taxpayer and any other person with respect to such property or rights to property arising from such surrender or payment.

* * * * *

SEC. 6343. AUTHORITY TO RELEASE LEVY AND RETURN PROPERTY.

(a) *Release of Levy.*—It shall be lawful for the Secretary, under regulations prescribed by the Secretary, to release the levy upon all or part of the property or rights to property levied upon where the Secretary determines that such action will facilitate the collection of the liability, but such release shall not operate to prevent any subsequent levy.

(b) *Return of property.*—If the Secretary determines that property has been wrongfully levied upon, it shall be lawful for the Secretary to return—

(1) the specific property levied upon,

(2) an amount of money equal to the amount of money levied upon, or

(3) an amount of money equal to the amount of money received by the United States from the sale of such property.

Property may be returned at any time. An amount equal to the amount of money levied upon or received from such sale may be returned at any time before the expiration of 9 months from the date of such levy. For purposes of paragraph (3), if property is declared purchased by the United States at a sale pursuant to section 6335(e) (relating to manner and conditions of sale), the United States shall be treated as having received an amount of money equal to the minimum price determined pursuant to such section or (if larger) the amount received by the United States from the resale of such property.

(c) *Interest.*—Interest shall be allowed and paid at the overpayment rate established under section 6621—

(1) in a case described in subsection (b)(2), from the date the Secretary receives the money to a date (to be determined by the Secretary) preceding the date of return by not more than 30 days, or

(2) in a case described in subsection (b)(3), from the date of the sale of the property to a date (to be determined by the Secretary) preceding the date of return by not more than 30 days.

SEC. 6532. PERIOD OF LIMITATION ON SUITS.

* * * * *

(c) *Suits by Persons Other than Taxpayers.*—

(1) *General Rule.*—Except as provided by paragraph (2), no suit or proceeding under section 7426 shall be begun after the expiration of 9 months from the date of the levy or agreement giving rise to such action.

(2) *Period when Claim is Filed.*—If a request is made for the return of property described in section 6343(b), the 9-month period prescribed in paragraph (1) shall be extended for a period of 12 months from the date of filing of such request or for a period of 6 months from the

date of mailing by registered or certified mail by the Secretary to the person making such request of a notice of disallowance of the part of the request to which the action relates, whichever is shorter.

SEC. 7426. CIVIL ACTIONS BY PERSONS OTHER THAN TAXPAYERS.

(a) *Actions Permitted.*—

(1) *Wrongful Levy.*—If a levy has been made on property or property has been sold pursuant to a levy, any person (other than the person against whom is assessed the tax out of which such levy arose) who claims an interest in or lien on such property and that such property was wrongfully levied upon may bring a civil action against the United States in a district court of the United States. Such action may be brought without regard to whether such property has been surrendered to or sold by the Secretary.

*****

(b) *Adjudication.*—The district court shall have jurisdiction to grant only such of the following forms of relief as may be appropriate in the circumstances:

(1) *Injunction.*—If a levy or sale would irreparably injure rights in property which the court determines to be superior to rights of the United States in such property, the court may grant an injunction to prohibit the enforcement of such levy or to prohibit such sale.

(2) *Recovery of Property.*—If the court determines that such property has been wrongfully levied upon, the court may—

(A) order the return of specific property if the United States is in possession of such property;

(B) grant a judgment for the amount of money levied upon; or

(C) if such property was sold, grant a judgment for an amount not exceeding the greater of—

(i) the amount received by the United States from the sale of such property, or

(ii) the fair market value of such property immediately before the levy.

For the purposes of subparagraph (C), if the property was declared purchased by the United States at a sale pursuant to section 6335(e) (relating to manner and conditions of sale), the United States shall be treated as having received an amount equal to the minimum price determined pursuant to such section or (if larger) the amount received by the United States from the resale of such property.

*****

(g) *Interest.*—Interest shall be allowed at the overpayment rate established under section 6621—

(1) in the case of a judgment pursuant to subsection (b)(2)(B), from the date the Secretary receives the money wrongfully levied upon to the date of payment of such judgment; and

(2) in the case of a judgment pursuant to subsection (b)(2)(C), from the date of the sale of the property wrongfully levied upon to the date of payment of such judgment.

(h) *Cross Reference.*—For period of limitation, see section 6532(c).

APPENDIX D

The following are sections from the General Conditions part of Site Development Contract for the Marion County City-County Complex.

* * * * *

18.2 If the CONTRACTOR is adjudged a bankrupt or insolvent, or makes a general assignment for the benefit of its creditors, or if a trustee or receiver is appointed for the CONTRACTOR or for any of its property, or if CONTRACTOR files a petition to take advantage of any debtor's act, or to reorganize under the bankruptcy or applicable laws, or repeatedly fails to supply sufficient skilled workmen or suitable materials or equipment, or repeatedly fails to make prompt payments to SUBCONTRACTORS or for labor, materials or equipment or disregards laws, ordinances, rules, regulations or orders of any public body having jurisdiction of the WORK or disregards the authority of the ENGINEER, or otherwise violates any provision of the CONTRACT DOCUMENTS, then the OWNER may, without prejudice to any other right or remedy and after giving the CONTRACTOR and its surety a minimum of ten (10) days from delivery of a WRITTEN NOTICE, terminate the services of the CONTRACTOR and take possession of the PROJECT and of all materials, equipment, tools, construction equipment and machinery thereon owned by the CONTRACTOR, and finish the WORK by whatever method the OWNER may deem expedient. In such case the CONTRACTOR shall not be entitled to receive any further payment until the WORK is finished. If the unpaid balance of the CONTRACT PRICE exceeds the direct and indirect costs of completing the PROJECT, including compensation for additional professional services, such excess SHALL BE PAID TO THE CONTRACTOR. If such costs exceed such unpaid balance, the CONTRACTOR will pay the difference to the OWNER. Such costs incurred by the OWNER will be determined by the ENGINEER and incorporated in a CHANGE ORDER.

* * * * *

23.1 Neither the CONTRACTOR nor the OWNER shall sell, transfer, assign, or otherwise dispose of the Contract or any portion thereof, or of any right, title or interest

therein, or any obligations thereunder, without written consent of the other party.

*****

No. 89-637

FILED
NOV 13 1989
JOSEPH F. SPANIOL, JR.
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

RAYMOND PROZZILLO, JESS BOROWSKI, BETTY GILL, JOHN CARSON AND MARION COUNTY, WEST VIRGINIA,
Petitioners,

v.

AMERICAN STATES INSURANCE COMPANY,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

RESPONDENT'S BRIEF IN OPPOSITION

E. JOEL WESP
WESP & OSTERKAMP
A LEGAL PROFESSIONAL ASSOCIATION
50 West Broad Street
Suite 3300
Columbus, OH 43215
(614) 228-2997

Attorney for Respondent

QUESTION PRESENTED

Should this Court review the judgment of the Fourth Circuit Court of Appeals affirming the district court's Order of Summary Judgment (unopposed by petitioners before the district court), that the Marion County Commission unlawfully disbursed funds belonging exclusively to American States Insurance Company in order to pay an IRS levy issued upon a delinquent taxpayer which was a completely different and separate entity from American States Insurance Company?

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No. 89-637

IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

RAYMOND PROZZILLO, JESS BOROWSKI, BETTY GILL, JOHN CARSON AND MARION COUNTY, WEST VIRGINIA,
Petitioners,

v.

AMERICAN STATES INSURANCE COMPANY,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

RESPONDENT'S BRIEF IN OPPOSITION

Respondent, American States Insurance Company, respectfully requests that this Court deny the petition for a writ of certiorari seeking review of the Fourth Circuit's decision in the case at bar. The decisions of the Fourth Circuit Court of Appeals and of the United States District Court for the Northern District of West Virginia are unreported, but appear in the Petitioners' Appendix at pages 1A and 4A, respectively.

STATEMENT OF THE CASE

On or about August 22, 1980, American States Insurance Company entered into an agreement of indemnity with Arthur S. Stover dba P & S Coal Construction Company, whereby American States would provide payment and performance surety bonds on behalf of P & S for its construction contracts. The agreement provided that P & S would assign and transfer to American States all of its rights in contracts referred to in the bond, effective upon breach of any contract referred to in any surety bond issued pursuant to the agreement. (Affidavit of Thomas E. Crafton, Paragraph 3 and Exhibit A thereto).

On July 1, 1981, P & S contracted with Marion County and the Marion County Commission for the construction of a city-county complex in Fairmont, West Virginia. American States provided payment and performance surety bonds on behalf of P & S for the performance of work and material under the terms of this agreement. (Crafton Affidavit, Paragraph 4 and Exhibit B thereto). P & S defaulted on its construction contract with Marion County on December 1, 1981, and requested that American States complete the performance of the contract. At that time, American States became subrogated to all of the rights and obligations of P & S, and took immediate assignment of all contract balances, retainages and payments in progress. (Crafton Affidavit, Paragraphs 5-8).

On December 15, 1981, both P & S and American States notified the County Commission that all contract balances, retainages and payments in progress had been assigned over to American States and were to be withheld until American States, as surety, fulfilled its bond obligations and made claims for these amounts. (Crafton Affidavit, Paragraph 7 and Exhibits C and D thereto). At that

time, the County Commission was holding approximately $60,000 under the county contract which P & S had assigned to American States. Pursuant to the terms of its surety bond, American States paid in excess of $140,000, and substantially completed the contractual obligations as of November 4, 1982. (Crafton Affidavit, Paragraph 9).

On July 9, 1982, the Internal Revenue Service issued a notice of levy on wages, salary and other income belonging to delinquent taxpayer, Arthur H. Stover, dba P & S Coal Company, which the County Commission had in its possession. (Deposition of Charles Anderson, Exhibit D-1). American States also received a notice of this levy, and promptly informed the IRS that American States Insurance Company was the exclusive owner of the funds being retained by the county on this contract. (Crafton Affidavit, Paragraph 10 and Exhibit E).

Upon receiving the levy, County Administrator John Carson telephoned the IRS, and learned that American States had requested a hold on any payment from the Marion County contract. (Deposition of John Carson, p. 6). Carson had also been notified earlier by American States of its interest in the funds being held by the county. (*Id.*). The County Commission consulted Prosecuting Attorney Charles E. Anderson as to whether the county should pay the IRS levy. (Deposition of J. Carson, p. 6). Mr. Anderson opined that the County Commission should pay the levy out of the funds being retained on this contract. (Deposition of C. Anderson, pp. 5, 10, 11 and Exhibit D-3). At the time he stated his opinion, however, Anderson was unaware that P & S had assigned all contract

balances to American States pursuant to the surety agreement, and he did not consider the impact of the assignment of the contract balances in rendering his opinion. (Deposition of C. Anderson, p. 14).

The County Commission notified American States Insurance Company on September 8, 1982 that the contract balances and retainages were being held pending completion of the project. (Deposition of C. Anderson, Exhibit D-6). American States was not given any advance notice that the County intended to pay the IRS levy, and deduct the amount of the payment from the contract balances and retainages. Nonetheless, on or about September 17, 1982, Marion County issued a check for $17,546.36 to the Internal Revenue Service in payment of the IRS levy upon P & S Coal Company's property. (Deposition of C. Anderson, Exhibits D-7 and D-16).

About one month after the check had been issued, American States was first notified that the county intended to disburse certain amounts from the contract balances. (Deposition of C. Anderson, Exhibit D-10). In this letter, the county gave American States ten days to contest any of the proposed payments, but said nothing about the funds which had already been disbursed to the IRS out of American States' account. After receiving the letter, American States promptly sent a telegram to Marion County objecting to any and all payments being made out of the contract balances. (Deposition of C. Anderson, Exhibit D-11).

On November 5, 1982, after learning that American States had become subrogated to all funds held by the Marion County Commission, Prosecuting Attorney Anderson issued a second opinion letter in which he changed his advice so as to notify the county that "no payment can be

made from this account without the approval of American States Insurance Company." (Deposition of C. Anderson, Exhibit D-12). Despite this advice, the county failed to credit the contract balance account with the amount that it had paid to the IRS.

On April 18, 1983, American States demanded repayment of the contract balances and retainages which it then believed to be in the amount of $35,689.66 plus interest. (Crafton Affidavit, Paragraph 19).

Despite the County Commission's admission that American States became entitled to the contract balance on December 21, 1984, the Commission still refused to release the funds. American States filed a diversity action in the United States District Court for the Northern District of West Virginia on January 30, 1985, seeking the return of funds already disbursed and the release of funds still retained by the County.

On November 17, 1987, American States moved for Summary Judgment, and properly served each of the petitioners (defendants below) with a copy of the Motion. American States served the Motion a second time upon defense counsel, in response to complaints about poor xerographic quality of the first copy.

Petitioners failed to respond to the Motion in a timely manner. They filed no Memorandum in Opposition, they raised no defenses, they presented no evidence, and they did not ask an extension of time in which to do so. More than five months after American States moved for summary judgment, the District Court still had not received any response from the petitioners, and it issued its Order granting American States' Motion for Summary Judgment. (*See,* Memorandum Opinion of the U.S. District Court for

the Northern District of West Virginia, Petitioners' Appendix at page 4A).

Within ten days of the date on which the District Court granted summary judgment, petitioners' counsel filed its responses: a Motion to Amend the Judgment, or in the Alternative for Relief for Judgment, and also a Memorandum in Opposition to the Motion for Summary Judgment. The Court denied each of these Motions, finding no basis for allowing petitioners to present evidence at that point in the litigation.

The petitioners then appealed the District Court's decision to the United States Court of Appeals for the Fourth Circuit, but did not assert error in the District Court's summary judgment procedure or in that Court's overruling of petitioners' Motion for Relief from Judgment as a basis for its appeal. Instead, their brief raised new arguments and defenses which were never presented to the District Court regarding the propriety of the disbursements by the County Commission, the accrual date of pre-judgment interest, and the validity of American States Insurance Company's claim based upon 42 U.S.C. Section 1983. The Fourth Circuit affirmed the District Court's ruling:

> "There is no merit in the county's appeal. Summary judgment for the plaintiff was properly entered. The county knew of the assignment by the construction company to the insurance company and had no right to treat the retained funds as property of the construction company subject to its command and to the levy of the United States . . . In doing so, it completely ignored the assignment . . . of all the construction company's interest in the funds withheld by Marion

County." (Opinion of the Fourth Circuit Court of Appeals, Petitioners' Appendix, at page 3A).

The petitioners have now petitioned this Court for a writ of certiorari, once again raising arguments never presented to the District Court. Petitioners argue that the Fourth Circuit's decision conflicts with a decision of another Court of Appeals and with decisions of this Court, and that review is warranted because of problems concerning the application of the Federal Tax Lien Act. For the reasons set forth below, the petition for a writ of certiorari should be denied.

REASONS WHY THE PETITION SHOULD BE DENIED

I. Petitioners Did Not Properly Raise Or Preserve Any Of Their Factual Or Legal Arguments In Support Of The Petition, Hence This Court Lacks Jurisdiction To Review Petitioners' Arguments.

At the time the District Court issued its Order for Summary Judgment, the Court had before it no evidence or arguments on behalf of the petitioners, for the simple reason that petitioners presented no evidence and raised no defenses in the District Court. It is a basic principle of federal civil procedure that an appellate court reviews only issues and evidence heard by the trial court. *United States v. One 1971 Mercedes Benz Two-Door Coupe, etc.*, 542 F.2d 912 (4th Cir. 1976). By failing to raise defenses or present evidence in opposition to the respondent's Motion for Summary Judgment in the District Court, the petitioners have waived any such arguments or defenses. Jurisdiction does not now lie with this Court to review arguments of fact or law which were never presented to the court of record.

Petitioners' only excuse for their failure to present defenses and introduce evidence to the trial court is a lack of diligence. In the case at bar, the petitioners were twice served with American States' Motion for Summary Judgment, and were well aware of its filing date. More than four months passed between the date the Motion was served upon petitioners' counsel for a second time, and the date when the Court issued its Order of Summary Judgment on April 20, 1988. During that time, petitioners made no attempt to respond or reply to the Motion, and gave no excuse for failure to respond pursuant to Federal Rule of Civil Procedure 56(f).

This Court has consistently followed a policy of refusing to review arguments and defenses that were never considered by the trial court. *United States v. Donnelly's Estate,* 397 U.S. 286, 90 S. Ct. 1033, 25 L. Ed. 2d 312 (1970). Likewise, where a petitioner's contentions have not been assigned as error in the lower courts, they are not the proper subject of this Court's review. *Sonzinsky v. United States,* 300 U.S. 506, 57 S. Ct. 554, 81 L. Ed. 772 (1937). The purpose of this rule is to allow parties the opportunity to offer all relevant evidence at the trial level and to avoid surprise on appeal by issues on which they had no opportunity to introduce evidence. *Singleton v. Wulff,* 428 U.S. 106, 96 S. Ct. 2868, 2877, 49 L. Ed. 2d 826 (1976).

Because the petitioners failed to introduce any testimony or evidence whatsoever supporting their arguments and defenses in the court of record, and moreover, because they have never assigned the District Court's summary judgment procedure as error, all of the petitioners' defenses and arguments have been waived. They are not the proper subject of review by the Supreme Court of the United States.

II. The Decision Of The United States Court Of Appeals For The Fourth Circuit Does Not Conflict In Principle With This Court's Decisions Cited In The Petition.

The petitioners have advanced several decisions of this Court in support of their argument that a person holding funds belonging to a delinquent taxpayer must release those funds in response to an Internal Revenue Service levy, even though there may be competing claims to the funds. This argument, and each of the cases cited by petitioners, completely misses the point of this litigation.

Throughout their petition, the petitioners have portrayed American States' ownership of the retained funds merely as a "competing claim" upon funds belonging to a delinquent taxpayer. The defect in the petitioners' "competing claim" analysis was framed in clear terms by the Fourth Circuit:

> "It [petitioners] treated the claim of the insurance company as no more than a competing claim upon the fund. In doing so, [the petitioners] completely ignored the assignment of the construction company to the insurance company of all the construction company's interest in the funds withheld by Marion County." (Opinion of the Fourth Circuit Court of Appeals, Petitioners' Appendix, at page 3A).

Immediately upon default by P & S, American States became the sole owner of the retained funds, and P & S no longer had any interest whatsoever in those funds. Petitioners are now foreclosed from relitigating this fact—which is fatal to their petition.

Petitioners have cited *United States v. National Bank of Commerce,* 472 U.S. 713, 105 S. Ct. 2919, 86 L. Ed. 2d 565 (1985) as an opinion of this Court which "give[s] support to the concept of discharge from liability of persons honoring a levy." (petition for writ of certiorari, page 5-6). That opinion has no relevance or applicability to the petitioners' argument in the case at bar. Marion County was not "honoring a levy" when it surrendered American States' property in response to a levy upon the assets of delinquent taxpayer, P & S Coal and Construction Co. Moreover, unlike the fact pattern of *United States v. National Bank of Commerce,* where there were competing claims to the property held, this case involves property which was solely and indisputably owned by American States Insurance Co., an entity bearing no affiliation to the delinquent taxpayer. There were no "competing claims" in this case.

The fatal distinction between the cases cited by petitioners and the case at bar is the undisputed fact that American States Insurance Company was the sole owner of all contract balances and retainages being held by Marion County as of December 1, 1981, when it became subrogated to those retainages upon the default of P & S Coal. Thereafter, P & S Coal had no interest in, nor any right to the contract funds being held by the Marion County Commission. Fourteen days after the default, the Marion County Commission was expressly notified in writing by both P & S Coal and American States Insurance Company that American States was the assignee of the contract rights, pursuant to the indemnity agreement between P & S Coal and American States. Therefore, when the Marion County Commission received the IRS levy on July 12, 1982, upon all wages, salary, and other income belonging

to the delinquent taxpayer, P & S Coal Company, the Marion County Commission was no longer in the possession of any property whatsoever which belonged to the delinquent taxpayer. At that point, all funds held by the Marion County Commission were instead the exclusive property of American States Insurance Company.

Finally, the case cited by the petition, *United States v. National Bank of Commerce,* 472 U.S. 713, 105 S. Ct. 2919, 86 L. Ed. 2d 565 (1985), actually advances the respondent's argument because the *National Bank of Commerce* Court expressly recognized that a party "that is neither 'in possession of' nor 'obligated with respect to' property or rights to property belonging to the delinquent taxpayer" has a complete defense to compliance with a tax levy issued upon the delinquent taxpayer's property. *United States v. National Bank of Commerce,* 36 L. Ed. 2d 565 at 575. *See, also, United States v. Sterling National Bank & Trust Co. of New York,* 494 F.2d 919, 921 (2nd Cir. 1974); *Bank of Nevada v. United States,* 251 F.2d 820 (9th Cir. 1957), *cert. denied,* 356 U.S. 938, 78 S. Ct. 780, 2 L. Ed. 2d 813 (1958). The Fourth Circuit's decision in the case at bar does not, therefore, conflict with any decision of this Court.

III. The Decision Of The Fourth Circuit Court Of Appeals Does Not Conflict With Decisions Of Other Courts Of Appeals.

Petitioners argue that the opinion of the Sixth Circuit Court of Appeals in *Commonwealth of Kentucky, United Pacific Insurance Company v. Laurel County,* 805 F.2d 628 (6th Cir. 1986), *cert. denied* 484, U.S. 817, 108 S. Ct. 72 (1987), conflicts with the decision of the Fourth Circuit Court of Appeals in the case at bar. Once again, the case

cited cannot even be compared to the case at bar, because of one crucial distinction in the facts of the two cases.

In both cases, the county held funds pending the completion of a county construction project, and in both cases, the county was served with an IRS levy for unpaid taxes of a delinquent contractor. In the case at bar, however, it is clear that the delinquent taxpayer had absolutely no property rights to the funds being held by the county. To the contrary, in the Sixth Circuit case cited by petitioners, the court expressly acknowledged that the delinquent taxpayer "indeed possessed 'property' or 'rights to property' that had been surrendered in response to the levy". *Commonwealth of Kentucky, United Pacific Insurance Company,* 805 F.2d at 634. This factual distinction justifies the difference between the holding of the Sixth Circuit in *United Pacific Insurance* and the holding of the Fourth Circuit in the case at bar. In the former case, the county surrendered property to the IRS in which the delinquent taxpayer had an interest; in the instant case, the county surrendered funds to the IRS in which the delinquent taxpayer had no interest whatsoever, but which were instead property of a non-delinquent taxpayer having no affiliation with the delinquent taxpayer.

In contrast to the factual disparities between the case at bar and the Sixth Circuit case cited by the petition, the Fifth Circuit has decided a very similar case to the one at bar in *Trinity Universal Insurance Company v. United States,* 382 F.2d 317 (5th Cir. 1967). In that case, a contractor defaulted on a government contract, and a surety completed the construction under agreement with the government. The defaulting contractor later became delinquent on its federal taxes, and the government attempted to set-off the amount of the delinquent taxes from the assets to

which the surety had become subrogated. The Fifth Circuit acknowledged the surety's superior rights to the funds, holding that the surety had the right to all retained funds and remaining progress money held by the government, free from set-off for taxes owed by the contractor. The decision of the Fourth Circuit, therefore, does not conflict with any factually-comparable decision of any other Court of Appeals.

IV. The Decision Below Does Not Present Any Problems Concerning Application Of The Federal Tax Lien Act.

The issue on which the petitioners are seeking this Court's review has been portrayed in the petition as one in which a stakeholder is asked to surrender property to the IRS, where the property has more than one claimant, and where only one of those claimants is a delinquent taxpayer. That description mischaracterizes the fact pattern involved in this case.

In the case at bar, there were no "competing claimants" to the funds being held by Marion County. American States was the sole owner and sole claimant to those funds. P & S Coal had no ownership rights in the funds retained by the county, and it in fact expressly notified the county that all contract balances, retainages and payments in progress had been assigned over to American States. (Crafton Affidavit, Paragraph 7 and Exhibits C and D thereto). American States also notified the county of the default and of its right to the retainages following the default. Therefore, there is no question that the county knew that American States Insurance Company was the exclusive owner and the only claimant to the funds which it held pending the completion of the city/county complex. When the facts

surrounding the contractor's pre-levy assignment of contract balances and retainages to the surety were finally brought to the attention of petitioners' prosecuting attorney, the county's attorney at once recognized the exclusive property and subrogation rights of the respondent, reversed his earlier uninformed opinion, and advised the county that no funds could be disbursed from the contract balances and retainages without the surety's consent.

The petition cites Section 6331(a) of the Internal Revenue Code of 1954 which stands for the proposition that "the government may collect taxes of a delinquent taxpayer 'by levy upon all property and rights to property . . . belonging to such person.' " The petition further refers to Section 6332(a) which provides that any person in possession of property subject to a levy shall, upon demand of the Secretary, surrender such property or rights . . . to the Secretary. The Marion County Commission was not following the mandate of either of the cited sections when it made the disbursements in question, however, because it was not in possession of any property belonging to the delinquent taxpayer, P & S Coal Company. Instead, the sole owner of the contract balances and retainages held by the County Commission was American States Insurance Company, a clearly non-delinquent taxpayer with no levy against its assets.

Petitioners argue that "in the absence of a rule providing for discharge of liability upon payment, the person levied upon has no certain or reasonable alternatives." This argument is without merit. There is no need for this Court to review the basic legal and logical principle that a party who is not in possession of any levied-upon property need not surrender such non-existent property, and cannot possibly be penalized for failure to surrender such property

to the IRS. *See, United States v. Montchanin Mills, Inc.*, 512 F. Supp. 1192 (D. De. 1981); *United States v. Commonwealth of Pennsylvania, Department of Highways*, 349 F. Supp. 1370 (E.D. Pa. 1972); *United States v. New England Merchants National Bank*, 465 F. Supp. 83 (D. Mass. 1979); *United States v. Trans World Bank*, 382 F. Supp. 1100 (C.D. Ca. 1974); *United States v. DeCicco*, 170 F. Supp. 394 (S.D.N.Y. 1959). This case presents no significant or novel questions or controversies as to how the Federal Tax Lien Act should be applied.

CONCLUSION

For the reasons stated, the petition for a writ of certiorari to the United States Court of Appeals for the Fourth Circuit should be denied.

Respectfully submitted,

E. JOEL WESP
WESP & OSTERKAMP
A LEGAL PROFESSIONAL ASSOCIATION
50 West Broad Street, Suite 3300
Columbus, OH 43215
(614) 228-2997

Attorneys for Respondent

CERTIFICATE OF SERVICE

I hereby certify that on November 10, 1989, three copies of the Respondent's Brief in Opposition were mailed postage prepaid, to John C. Higinbotham, Assistant Prosecuting Attorney of Marion County, Marion County, Courthouse, Fairmont, West Virginia 26554, Counsel for petitioners.

I further certify that all parties required to be served have been served.

E. JOEL WESP
WESP & OSTERKAMP
A LEGAL PROFESSIONAL ASSOCIATION
50 West Broad Street, Suite 3300
Columbus, OH 43215
(614) 228-2997

Attorneys for Respondent

Supreme Court
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No. 89-637

IN THE

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OCTOBER TERM, 1989

RAYMOND PROZZILLO, JESS BOROWSKI, BETTY GILL, JOHN CARSON AND MARION COUNTY, WEST VIRGINIA,
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AMERICAN STATES INSURANCE COMPANY,
Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Fourth Circuit

PETITIONERS' REPLY TO RESPONDENT'S BRIEF IN OPPOSITION

JOHN C. HIGINBOTHAM
Assistant Prosecuting Attorney of Marion County
Marion County Courthouse
Fairmont, West Virginia 26554
(304) 367-5380 (304) 366-2900

PRESS OF RAM PRINTING, HYATTSVILLE, MD 20781 (301) 864-6662

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STATUTES

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IN THE

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RAYMOND PROZZILLO, JESS BOROWSKI, BETTY GILL, JOHN CARSON AND MARION COUNTY, WEST VIRGINIA,
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AMERICAN STATES INSURANCE COMPANY,
Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Fourth Circuit

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PETITIONER'S REPLY TO RESPONDENT'S BRIEF IN OPPOSITION

PRELIMINARY STATEMENT

The Respondent, in its brief in opposition, raises an issue not covered in the petition for writ of certiorari, and has, in addition, misconstrued the Petitioners' arguments, thus requiring additional comment to aid the Court in its determination.

ARGUMENTS

1. The Fourth Circuit Considered The Issue Now Raised In The Petition For A Writ Of Certiorari Notwithstanding Respondent's Objection, Thus Curing Any Jurisdictional Defects.

In Petitioners' appeal to the Fourth Circuit, the issue as to liability to Respondent for honoring the Internal Revenue Service levy was squarely raised and thoroughly briefed by both sides. The Petitioners' brief, at pages 8 and 9 quoted at length from *United States* v. *National Bank of Commerce*, 472 U.S. 713 (1985), setting forth the principle that the statutory remedies for wrongful levy precluded exposing the stakeholder to double liability were it to honor the Internal Revenue Service levy.

Notwithstanding Respondent's objection to its jurisdiction to entertain the appeal for Petitioners' failure to assert any defenses at the trial, the Fourth Circuit did in fact consider this issue on its merits. This is clearly indicated by the main portions of the Fourth Circuit's Memorandum Opinion:

> Marion County admitted the facts. It made no claim that it was entitled to pay itself the $3,000, but it did insist that it was entitled to deduct the amount it had paid to the Internal Revenue Service. It treated the claim of the insurance company as no more than a competing claim upon the fund. It took the position that it had no defense to the claim of the United States. In doing so it completely ignored the assignment of the construction company to the insurance company of all the construction company's interest in the funds withheld by Marion County.
>
> There is no merit in the county's appeal. Summary judgment for the plaintiff was properly entered. The county knew of the assignment by the construction company to the insurance company and had no right

> to treat the retained funds as property of the construction company subject to its command and to the levy of the United States. (Opinion of the Fourth Circuit Court of Appeals, Petitioners' Appendix, at Page A3).

In *Singleton* v. *Wulff*, 428 U.S. 106 (1976), this Court stated that "[t]he matter of what questions may be taken up and resolved for the first time on appeal *is one left primarily to the discretion of the courts of appeals, to be exercised on the facts of individual cases.*" Where the court of appeals exercises such discretion and considers the newly raised issues on the merits, its decision to do so will not be disturbed by this Court if the objecting party did not contend that the record was inadequate for such consideration. See *Sabbath* v. *United States*, 391 U.S. 585, 588, fn. 11 (1968).

In the instant case, the issue raised is one of law. The Respondent has made no contention herein that it would have introduced additional evidence had this defense been raised at the trial level. Moreover, it also failed, before the Fourth Circuit, to demonstrate in what manner it was being prejudiced. It thus was unable to convince the court of appeals to summarily dismiss the appeal on the general rule that federal appellate courts will not consider an issue not passed upon below.

Accordingly, it is clear that the Fourth Circuit did consider the issue petitioned, and that the Respondent has failed to demonstrate the court abused its discretion in doing so. The asserted jurisdictional defect has thus been cured and the case is ripe for consideration on the merits.

2. The Petitioners Are Not Attempting To Relitigate The Question Of Whether Respondent Was The True Owner Of The Funds Paid To The Internal Revenue Service.

The Respondent, throughout its Brief in Opposition, asserts that Petitioners are seeking to have this Court

review the question of ownership of the funds paid to the Internal Revenue Service. On the contrary, the issue raised by the Petitioners assumes that ownership of the funds paid to the Internal Revenue Service will, as in the instant case, ultimately be determined to be that of a third party, not the taxpayer. Indeed, where the funds are determined to be those of the taxpayer, i.e., subject to levy, section 6332(e), effective for levies issued on or after July 1, 1989, now provides for a discharge from liability to any person upon payment to the Internal Revenue Service.

The Petitioners are requesting this Court to review the decision of the court below for the purpose of establishing a rule to protect a stakeholder who pays the Internal Revenue Service pursuant to a levy *before ownership is established*. The Petitioners in this case and thousands of others similarly situated cannot, because of the legal and factual complexities of ownership determination, reasonably make that decision without substantial risk or protracted litigation.

For obvious policy reasons, the discharge of liability to third parties is needed to insure prompt payment of the tax liabilities in these disputed ownership situations. Although section 6332(e) fails to address the instant situation, it does not preclude a judicially established rule exonerating the stakeholder from liability. Cf. *United Pacific Insurance Company* v. *Laurel County*, 805 F.2d 628, 635, fn. 9 (6th Cir. 1986), *cert. denied*, ___ U.S. ___, 108 S. Ct. 72 (1987).

CONCLUSION

The petition for writ of certiorari should be granted.

Respectfully submitted,

JOHN C. HIGINBOTHAM
Assistant Prosecuting Attorney of Marion County
Marion County Courthouse
Fairmont, West Virginia 26554
(304) 367-5380/(304) 366-2900

CERTIFICATE OF SERVICE

I hereby certify that on November 29th, 1989, three copies of Petitioners' Reply to the Respondent's Brief in Opposition were mailed, postage prepaid, to E. Joel Wesp, Esq., Wesp & Osterdamp, A Legal Professional Association, 50 West Broad Street, Suite 3300, Columbus, Ohio 43215, Counsel for Respondent.

I further certify that all parties required to be served have been served.

JOHN C. HIGINBOTHAM
Assistant Prosecuting Attorney of Marion County
Marion County Courthouse
Fairmont, West Virginia 26554
(304) 367-5380/(304) 366-2900